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Supreme Court of the United States

~~*October Term, 1905, No. 318*~~

October Term, 1906, No. 63

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JAMES H. McKENNEY

FREDERIC L. GRANT SHOE COMPANY

Appellant,

against

W. M. LAIRD COMPANY

Appellee

BRIEF FOR APPELLANT

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Supreme Court of the United States.

OCTOBER TERM, 1905. NO. 318.

OCTOBER TERM, 1906. NO. 63.

FREDERIC L. GRANT SHOE COMPANY,
Appellant.

vs.

W. M. LAIRD COMPANY.
Appellee.

Appeal from the judgment of the United States District Court for the Western District of New York, which, on June 7th, 1905, adjudged the appellant a bankrupt.

BRIEF FOR APPELLANT.

Statement of the Case.

The question presented attacks the jurisdiction of the District Court and is whether an unliquidated and disputed claim, based upon damages sustained upon the breach of warranty, which accompanied the sale of personal property, will support a petition in bankruptcy.

The appellant has only two creditors, namely, the appellee and The German-American Bank of Rochester, N. Y. (record page 10).

On July 15th (record pages 5 and 10) W. M. Laird Company, said appellee, a corporation organized under the laws of the State of New Jersey, having its principal place of business at Pittsburg, Pa. (record page 2) filed in the office of the Clerk of the United States District Court for the Western District of New York, its petition, signed by itself alone (record pages 2, 3, 4 and 10) asking that the Frederic L. Grant Shoe Company, said appellant, a manufacturing corporation, having its principal place of business at Rochester, New York, (record page 2) be adjudged a bankrupt. The claim of said appellee, upon which said petition in bankruptcy is founded, is based wholly upon an unliquidated demand for damages, sustained by reason of an alleged breach of warranty claimed to have accompanied the sale of personal property, (record pages 2, 3 and 10). A subpoena issued out of the District Court, together with the petition referred to, was served upon said appellant on July 18th, 1903 (record page 1). On July 28th, 1903, (record pages 7 and 11) said appellant filed in the office of the Clerk of said District Court, its answer (record pages 5, 6 and 7), wherein it denies the giving of the warranty and its breach. The claim, which is the basis of the petition in bankruptcy, is therefore not only unliquidated but disputed.

When the proceeding was reached for trial upon the petition and answer, said appellant, at the opening of the hearing, moved to dismiss said petition and said proceeding upon the ground that said District Court had no jurisdiction to entertain said proceeding or render a decree or order an adjudication of bankruptcy against said appellant(record pages 11 and 14). The reasons stated why said District Court had no jurisdiction of said proceeding were that said appellee, at the time of filing its petition herein, had no provable claim against said appellant to the extent of five hundred dollars ($500) or any other sum, and had no standing in Court to ask that said appellant be adjudged a bankrupt; that the claim of said appellant was based wholly upon damages alleged to have been sustained by it by reason of a pretended breach of a warranty which accompanied the sale of personal property, which damages had never been in any way liquidated, and the pretended facts upon which said damages were based were, by the answer, denied; that under the Bankruptcy Act of 1898, there was no possible way for said appellee's claim in bankruptcy to become liquidated, except pursuant to the provisions of section 63b, which provides for liquidating unliquidated claims in such manner

as the Court shall direct, and that thereafter such claims may be proved and allowed against the estate; that the statute plainly shows the intention that there shall first be an adjudication in bankruptcy before such unliquidated and disputed claim can be in any manner proved (record pages 14 and 15).

At the time of making said motion The German-American Bank of Rochester the only other creditor of said appellant (record page 10), appeared by its counsel and united in said motion (record page 11). Said motion was, by the Court, denied, to which ruling appellant's counsel then and there duly excepted (record page 15).

Upon the trial, which followed the denial of said motion, there was no testimony offered on the part of said appellant. Said appellee proceeded to establish its claim for said damages and it was established at the sum of three thousand four hundred and fifty-four dollars ($3,454) (record pages 11 and 15). The fact of insolvency and the commission of an act of bankruptcy on the part of said appellant was, in open Court, admitted, and the Court thereupon adjudged that said appellant was a bankrupt (record pages 11, 8 and 9). The Court thereafter made and filed its findings of fact and conclusions of law (record pages 9, 10, 11 and 12) and said appellant, feeling aggrieved by said judgment, filed assignments of error (record pages 13 and 14), together with its appeal from said judgment to this Court (record page 12), which appeal was allowed by the Judge of the District Court (record page 13), and the jurisdictional question referred to is duly certified to this court (record pages 14, 15).

SPECIFICATION OF ERROR RELIED UPON.

The court below erred in denying appellant's motion, made at the commencement of the hearing, to dismiss the proceeding for want of jurisdiction (record pages 11, 14 and 15) because an unliquidated and disputed claim, based upon damages sustained upon the breach of warranty which accompanied the sale of personal property, will not support a petition in bankruptcy.

This question is raised by appellant's exception to the court's ruling (record page 15), by the assignment of error (record pages 13 and 14), the allowance of this appeal (record page 13), and by the certificate of said jurisdictional question to this court (record pages 14 and 15).

ARGUMENT.

First.

THIS APPEAL WHICH PRESENTS A QUESTION OF JURISDICTION OF THE DISTRICT COURT ARISING UNDER THE BANKRUPTCY ACT OF JULY 1st, 1898, IS AFTER FINAL JUDGMENT WELL TAKEN UNDER THE PROVISIONS OF THAT ACT AND THE FIFTH SECTION OF THE JUDICIARY ACT OF MARCH 3d, 1891.

Bankruptcy act of July 1st, 1898, sections 24 and 25 (30 Stat. at L. 554, chap. 541, U. S. Comp. Stat. 1901, pp. 3431 and 3432).

Judiciary Act of March 3, 1891, section 5 (26 Stat. at L. 826, chap. 517, U. S. Comp. Stat. 1901, p. 549).

U. S. vs. Jahn, 155 U. S. 109, 114, 115.

Barders vs. First National Bank, 175 U. S. 526.

Second.

The provisions of the bankruptcy act of 1898 which are applicable to the question presented (30 Stat. at L. 554, chap. 541, U. S. Comp. Stat. 1901, pp. 3445 and 3447) are as follows:

"Section 59. Who may file and dismiss petitions.— * * * (*b*) Three or more creditors who have provable claims against any person which amount in the aggregate, in excess of the value of securities held by them, if any, to five hundred dollars or over; or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt."

"Section 63. Debts which may be proved.—(*a*) Debts of the bankrupt may be proved and allowed against his estate which are * * *

"(4) Founded upon an open account or upon a contract express or implied. * * *

"(*b*) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct and may thereafter be proved and allowed against his estate."

In this case, the claim, which is the basis of the petition in bankruptcy, is unliquidated and disputed, and therefore, at the time of

filing and serving the petition, it was not provable. The language of the statute is that an unliquidated claim may be liquidated as directed by the court and may *thereafter,* that is, after such liquidation, be proved. There must first be some proceeding in court in which the application for liquidation may be made, before such claim can become liquidated. No one can file a petition in bankruptcy unless he has, at the time of filing, a provable claim. The fact that he alleges a claim, which may by some subsequent proceeding or action become liquidated and undisputed, and thus provable, does not make him a creditor with a provable claim until such steps are taken. When the time arrives for application for liquidation, the court may decide that he has no claim. It may decide that the statement of facts presented by him is not substantiated by proof. In this case, there being less than twelve creditors, one creditor, whose claim equals five hundred dollars, may file a petition. His claim, however, must be provable, and it must amount at least to five hundred dollars. Until it is liquidated, who is to determine whether it amounts to as much as five hundred dollars? Is it sufficient that a creditor alleges that to be the fact? Upon liquidation the court may decide that the claim amounts to less than five hundred dollars. If the creditor is to decide this matter for himself, it would seem there could be no necessity for the provision of the law for liquidation. If he can determine that his claim amounts to more than five hundred dollars, why may he not fix the exact amount?

The question as to what constitutes a provable claim in involuntary petitions in bankruptcy, has been much discussed. It has been held that unliquidated claims based upon tort will not sustain a petition.

Beers v. Hamlin, 3 Am. Bkr. Rep. 745, 99 Fed. Rep. 695.
In re Brinckmann, 4 Am. Bkr. Rep. 551, 103 Fed. Rep. 65.

The same proposition with reference to actions for breach of warranty has been held in Florida and in Pennsylvania.

In *re Morales* (5 Am. Bkr. Rep. 425, 105 Fed. Rep. 761), was decided in January, 1901, by the United States District Court for the Southern District of Florida, and the opinion is written by Judge Locke. The headnote correctly states the case as follows: "An unliquidated claim for damages for breach of warranty in a contract may not be used as a basis for an adjudication in bankruptcy." In his opinion, Judge Locke refers to the fact that the ancient rule and

practice was that a breach of an alleged warranty, although based on a contract, was not an action for the performance or fulfillment of the contract, but was an action on the case sounding in tort, and could only be presented as such. There is no contract, express or implied, that the Grant Shoe Company would pay the Laird Company any amount of money. It is liable, if at all, for damages on account of a breach of its contract. Judge Locke continues: "It is only the force of law that gives damages for the breach of a warranty in such a case. I consider it should be classed with actions for tort, deceit or fraud, rather than contract, such as is contemplated in section 63, subdivision (a) Cl. 4 of the Law of Bankruptcy." Judge Locke refers, also, to the fact that after an adjudication in bankruptcy, a claim similar to the one presented in this petition might be presented under subdivision (b), section 63 of the Bankruptcy Act, and it would be the duty of the court to determine how such claim, although unliquidated, might be thereafter proved and allowed against the estate. He further says: "But I do not consider that the law contemplated that such an unliquidated claim as this, not capable of proof by any practice in bankruptcy, should be made a basis of an adjudication in bankruptcy." In that case the petition was demurred to and the demurrer was sustained.

In *re Big Meadows Gas Company* (7 Am. Bkr. Rep. 697, 113 Fed. Rep. 974), was decided by the United States District Court for the Northern District of Pennsylvania in February, 1902, the opinion being written by Judge Buffington. There are other questions considered,—a portion of the claim being liquidated and a portion being unliquidated. But it was held that the claim being one claim, presented as such, must be considered an unliquidated claim. The element for unliquidated damages was for a breach of contract. The petitioner's claim was based upon a written instrument and non-performance of its provisions. And it was held that the unliquidated character of some of the elements of the claim made it, as a whole, unliquidated, and subjected it as such to the limitations and statutory provisions incident to a claim of that kind. In his opinion, Judge Buffington uses the following language: "After careful and deliberate consideration of the question here involved, we have reached the conclusion that the unliquidated demand herein made only becomes a provable debt * * * after it has been judicially ascertained and liquidated in the statutory method set forth. Such construction is in accord with other provisions of the act. The provisions requiring petitioning creditors should have claims aggregating five hundred

dollars in excess of all securities, evidences that Congress felt there should be definite, ascertained claims, and that, too, in excess of all securities, as a foundation upon which to base a petition to adjudicate one a bankrupt. Where a claim against another has not been judicially ascertained and where its validity and certainty are evidenced by no paper, acknowledgment, or other admission of the debtor, it would offend our sense of right to allow such self-asserted claim to constitute sufficient ground for harassing another with a petition in bankruptcy. It will readily be seen that an averred but unfounded claim might be made an effective weapon to enforce an unjust demand or even to bankrupt a struggling but solvent debtor. Of course, no such consequence would result from the case at hand. The property of the company has been sold at sheriff's sale, but the question raised is jurisdictional." Judge Buffington, at page 700, cites many cases supporting his construction of the act. An order was granted dismissing the petition.

In both of the cases just cited, the petition was founded upon an unliquidated claim. It does not appear that the claim was also disputed. But is was held in these cases that where the petitioner's claim is based upon breach of contract, he has no standing in court to present a petition for adjudication in bankruptcy, unless his claim has been liquidated.

Matter of Manhattan Ice Company (7 Am. Bkr. Rep. 408, 114 Fed. Rep. 399), affirmed by the Circuit Court of Appeals in the Second Circuit in June, 1902, *sub nomine In re Stern* (8 Am. Bkr. Rep. 569, 116 Fed. Rep. 604), furnishes no authority against the claim that this petition should have been dismissed. In the *Manhattan Ice Company case* the claim was unliquidated, and it was based upon breach of contract. It appears that the fact of the breach of the contract was not disputed, and further, that the damages sustained by reason of the breach were far in excess of the sum of five hundred dollars. The most then, that can be claimed for the *Manhattan Ice Company case,* is, that where the claim is founded upon breach of contract, and the claim of breach is not disputed, and it appears that the damage sustained is sufficient in amount, that then such creditor has a standing in court as a petitioning creditor asking for an adjudication in bankruptcy. The most of the opinion in the Circuit Court of Appeals, which was written by Judge Townsend, is devoted to the question of whether there was a present right of action following immediately upon the breach, although by the terms of the contract the time for its performance had not yet

elapsed. It is submitted, no decision can be found which sustains a petition in involuntary bankruptcy where the petitioner's claim is not only unliquidated, but is also disputed. Under the bankruptcy act there is no possible way for the appellee's claim to become liquidated, except pursuant to the provisions of section 63 (b), which provides for proving unliquidated claims in such manner as the court shall direct, and that after such proof, such claims may be proved and allowed against the estate. This plainly shows the intention of the statute, that there should first be an adjudication in bankruptcy before such unliquidated claim can be in any manner proved. It must then be liquidated in such manner as the court directs, and after such liquidation it may be proved. Such time, of course, had not arrived at the time appellee filed its petition nor when the motion to dismiss was made at the trial. The appellee had no standing in court, and had no provable claim upon which to base its petition. There is no provision in the law for ascertaining the exact amount of the appellee's claim, before adjudication, and as is stated by Judge Buffington in the case of *In re Big Meadows Gas Company*, cited above, it will readily be seen that an averred but unfounded claim might be made an effective weapon to enforce an unjust demand. This question is, of course, jurisdictional, and if appellant is right in its position, the petition in bankruptcy should have been dismissed. The remedy of appellee is at once apparent. It should first, in the proper forum, if it thought it had a valid cause of action, have brought an action for recovery of the damage which it claims to have sustained, and there the question could have been properly tried and decided by a jury. If it had succeeded, this claim would then have become liquidated, and it might then have a standing in court to present a petition of this character.

Cases like the one at bar are not the only cases where the courts have held that a creditor has not a provable claim, though he may have a claim which may, at a later time, become such.

The Bankruptcy Act of 1898 contains provisions concerning preferences given within four months and then provides:

"Section 57, g. The claims of creditors who have received preferences shall not be allowed unless such creditors shall surrender their preferences."

Under this section a preferred creditor may, by surrendering his preference, prove his claim. Though he has a claim which, by proper action taken by him, may become provable, it cannot be said that he has a provable claim until such action is taken, and this is for the

same reason as in the case of a creditor with a disputed unliquidated claim. In the one case, the creditor may never surrender his preference; in the other he may never be able to establish his disputed unliquidated claim. In both cases he has no provable claim until the event, under which the claim may become provable, happens.

The situation of an innocent preferred creditor with reference to proving his claim, under section 60, has been considered by this court in *Pirie v. Chicago Title & Trust Company* (182 U. S. 438), where it is held that a creditor who has received payments of money from an insolvent debtor within four months before petition in bankruptcy was filed for the debtor, but who did not know or have reasonable cause to believe that the payments were intended to give him a preference, the debtor not intending to give a preference, cannot be compelled, under the Bankruptcy Act, section 60, b, to repay the money to the trustee in bankruptcy, but under section 57, g, he must surrender the preference that he has received before any claim by him against the estate can be allowed.

The District Court had found the facts and made its first conclusion of law as follows:

"*First.* That the payment made by appellants to the bankrupts at the time and in the manner above shown constitutes a preference, and that by reason of the failure and refusal of said appellants to surrender said preferences, *they were not entitled to prove* their claim against the bankrupts' estate" (page 442) thus holding that until surrender the creditor had no provable claim.

This court, in affirming the decision below, states that "the question presented by this record is whether payments in money made by an insolvent debtor to a creditor, the debtor not intending to give a preference, and the creditor not having reasonable cause to believe a preference was intended, did nevertheless constitute a preference within the meaning of the Bankrupt Act of 1898, and were required to be surrendered *as a condition of proving* the balance of the debt or other claims of the creditor." (Page 443.) In discussing this question, this court says: "What a preference is, is plain. What the effect of it is, if taken under the conditions mentioned, is equally plain. So taken, it may be recovered back. If not so taken, it may be kept or surrendered. Unless surrendered, he who received it *cannot prove his debt or other debts.* His election is between keeping the preference and surrendering it." (Page 447.) This court, by its decision in this case, has not only affirmed the finding of the court below, quoted above, but has taken occasion in its opinion to

emphasize the affirmance by restating the fact that until surrender the preferred creditor cannot prove his debt; that is, has no provable claim.

See also *In re Rogers Milling Co.* 4 Am. Bkr. Rep. 540.
In re Gillette & Prentice, 5 Am. Bkr. Rep. 119.
Phillips v. Dreher Shoe Co. 7 Am. Bkr. Rep. 326.

Before this proceeding was reached for trial in the District Court said appellant moved upon the same grounds to dismiss the proceedings. The motion was denied and upon petition to review was reviewed by the Circuit Court of Appeals, Second Circuit and there affirmed.

11 Am. Bkr. Rep. 48, 125 Fed. Rep. 576.
12 Am. Bkr. Rep. 349, 130 Fed. Rep. 881.

No appeal was then taken to this court because such decisions were both before the final judgment herein and an appeal at that time would have been premature.

Bardes vs. First National Bank, 175 U. S. 526.

It is submitted that the motion to dismiss made at the trial should have been granted and the exception (record page 15) was well taken.

The judgment appealed from should be set aside and reversed, and this court should decree that said petition in bankruptcy be dismissed for want of jurisdiction, with costs.

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